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Philip Morris case may pinch budget \$12 billion bond may threaten payouts to states



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By Al Crossacross@courier-journal.com
The Courier-Journal

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FRANKFORT, Ky. -- Kentucky, Indiana and other states could find it difficult to balance their budgets if an Illinois court judgment prevents Philip Morris USA from making payments under the national tobacco settlement.

On April 15, Philip Morris is supposed to pay Indiana \$52 million and Kentucky \$45 million as part of a \$2.5 billion installment to states to compensate them for health-care costs related to smoking.

But the company said in a letter Thursday that it may not be able to make the payments because a Madison County, Ill., judge has ordered it to post a \$12 billion bond to appeal a recent \$10.1 billion judgment in a case filed on behalf of individual smokers.

The possibility of not getting the money "puts a lot of things in jeopardy," including programs to help farmers diversify and to give young children a better start in life, said Mary Lassiter, Kentucky's acting state budget director. "It's very serious."

Lassiter said that if the problem isn't resolved, other programs could be affected because some of the tobacco money is supposed to be used to balance the state budget in the fiscal year that begins July 1.

Indiana legislators, meanwhile, are counting on tobacco settlement money to balance the state's budget and pay for key programs.

"Philip Morris USA is not financially able to post the enormous bond that the Madison County court has demanded," Denise Keane, the company's general counsel, said in the letter to Washington Attorney General Christine Gregoire, who helped negotiate the \$206 billion settlement in 1998 and is helping enforce it.

Gregoire said Friday that she would file a motion urging a lower bond if the matter isn't resolved soon to make sure the payments to states aren't jeopardized.

Philip Morris said yesterday that it is seeking a lower bond through the Illinois legislature and the courts.

Moody's Investors Service, which downgraded the bonds of Philip Morris and its parent company, Altria Group Inc., yesterday, said it believed the parent also might be asked to pitch



in.

Philip Morris spokesman Brendan McCormick said that for now, the company is focused on lowering the amount of the bond.

Moody's said the downgrading also reflects "the risk of future verdicts against the company where the bonding requirement is similarly crippling." Shares of Altria fell nearly 7 percent yesterday, or \$2.17, to \$29.96 a share, a new 52-week low.

McCormick said the company believes one of its grounds for appeal is that the Illinois lawsuit shouldn't have been certified as a class action.

The case was filed by smokers who alleged that Philip Morris wrongly led customers to believe that "light" brands are less harmful than regular cigarettes. The case was decided by the judge, not a jury.

In Kentucky, half the tobacco settlement money goes to the state Agricultural Development Board for grants aimed at diversifying the state's agricultural economy, in which tobacco is playing a shrinking role as government production quotas are cut and manufacturers get more tobacco from overseas.

The other half is divided between early-childhood development programs and health care. Of the latter, about 62 percent is designated as a subsidy for Kentucky Access, a state plan for Kentuckians whose medical conditions make it difficult for them to buy individual health insurance.

Lassiter said lack of the Philip Morris money likely would mean "a significant scaling back of all the programs where the money goes."

It could go beyond those programs, because this year the legislature took \$56 million that would have otherwise been available to the program and put it in the General Fund in order to balance the budget.

If Philip Morris were to miss this month's payment, the money available for the transfer would be only \$49 million. Tobacco companies' settlement payments are based on market share; Philip Morris accounts for half of the payments.

State insurance officials have said that use of the money to balance the budget wouldn't immediately affect the 1,749 people enrolled in Kentucky Access, but that it could cause problems in future years.

Lassiter said the state has plenty of money to balance the budget at the end of the fiscal year, June 30, but the prospect of less tobacco money "pushes next year's budget significantly out of balance."

Other health-care programs financed by tobacco settlement money include lung cancer research and smoking cessation and drug-abuse prevention programs. Those would suffer cuts if Philip Morris cannot make its expected payments, Lassiter said.

Next year's budget calls for Kentucky to receive a little more than \$109 million in tobacco settlement money. If Philip Morris' market share remains about half, its share of the payments to the state would be about \$55 million.

In Indiana, legislators are still trying to create a two-year budget that relies heavily on settlement money for popular health programs, including an insurance program for poor children and a prescription drug program for the low-income elderly.

House and Senate budget proposals also would use settlement money to make cash available for economic development proposals.

Yesterday, Senate Budget Subcommittee Chairman Bob Meeks, R-LaGrange, said the situation complicates budget negotiations, although he couldn't say just what would happen if the company fails to make its payment.

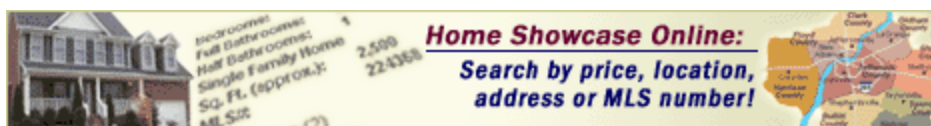
"It does change the way we have to approach the budget," Meeks said. "The only thing we can do now is wait and see if we find something out before we have to be done with the budget."

The session is scheduled -- by law -- to end on April 29.

Staff writer Lesley Stedman and The Associated Press contributed to this story.

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